

New Issue: Moody's assigns Aa2 to \$1.2B Mississippi GO bonds; outlook stable

Global Credit Research - 21 Jan 2015

Mississippi has \$5B in debt outstanding

MISSISSIPPI (STATE OF)
State Governments (including Puerto Rico and US Territories)
MS

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series 2015A (Tax-Exempt)	Aa2
Sale Amount	\$157,230,000
Expected Sale Date	02/02/15
Rating Description	General Obligation
General Obligation Refunding Bonds, Series 2015C (Tax-Exempt)	Aa2
Sale Amount	\$729,000,000
Expected Sale Date	02/02/15
Rating Description	General Obligation
Taxable General Obligation Bonds, Series 2015B	Aa2
Sale Amount	\$128,950,000
Expected Sale Date	02/02/15
Rating Description	General Obligation
Taxable General Obligation Refunding Bonds, Series 2015D	Aa2
Sale Amount	\$196,000,000
Expected Sale Date	02/02/15
Rating Description	General Obligation

Moody's Outlook STA

NEW YORK, January 21, 2015 --Moody's Investors Service has assigned Aa2 ratings to the State of Mississippi's General Obligation Bonds, Series 2015A (Tax-Exempt), Taxable General Obligation Bonds, Series 2015B, General Obligation Refunding Bonds, Series 2015C (Tax-Exempt) and Taxable General Obligation Refunding Bonds, Series 2015D. The bonds are expected to price the week of February 2.

SUMMARY RATING RATIONALE

Mississippi's Aa2 rating reflects conservative budgeting and mandated spending cuts in the event of revenue shortfalls, structural budgetary balance, offset by weak economic fundamentals and a slow economic recovery, as well as above-average fixed costs.

OUTLOOK

The stable outlook is consistent with our expectations of continuing economic recovery over the next 12-18 months, a structurally balanced fiscal 2016 budget, and limited use of debt to finance capital improvements.

WHAT COULD MAKE THE RATING GO UP

- Economic improvement that moves Mississippi closer to national average in terms of per-capita income and poverty rates

WHAT COULD MAKE THE RATING GO DOWN

- Economic decline
- Depletion of reserves, leading to negative available fund balances

STRENGTHS

- Fiscal conservatism institutionalized through mandatory spending cuts if revenues fall below 98% of the budgeted estimate
- Maintenance of sufficient reserves achieved through expenditure restraint
- Relatively stable economy

CHALLENGES

- Weak economic fundamentals including the nation's lowest per-capita income and highest poverty rate
- Sub-par economic recovery from 2007-2009 recession

RECENT DEVELOPMENTS

In November and December, the governor and legislature released their respective budget recommendations for fiscal year 2016. Both use a revenue growth projection of 3% over fiscal 2015 or \$166 million, which is realistic given current revenue trends and the recent improvement in the national economy. The executive proposal suspends, for a second consecutive year, the 2% set-aside and uses that money to fund credits for personal income taxpayers. The legislative recommendation reinstates the 2% set-aside, does not contain tax relief and keeps spending at the fiscal 2015 level. Both recommendations avoid using one-time funds for a second consecutive year, which is a sign of improved fiscal health. Given the relatively narrow gap between the two recommendations and the benign fiscal and economic picture, the final fiscal year 2016 budget will likely reflect restrained spending in line with available revenues.

General fund revenues increased 3.8% year-to-date as of December 2014. Revenue gains were the result of a well-balanced mix of sales, individual income and corporate income tax gains.

The state's unaudited 2014 financial statements indicate slowly improving financial health, with available fund balance increasing to 6.7% of revenues from 6.4% in fiscal 2013.

The economy is recovering slowly. Total employment stagnated during the past 12 months. The unemployment rate improved to 7.3% in November from 8.0% a year before that, but it remains above the national rate of 5.8%.

In March, the state published its first debt affordability study, adding a financial best practice to its governance.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

ECONOMY

Mississippi has historically ranked near the bottom among US states in terms of various economic measures, which may constrain its ability to raise revenues compared to wealthier states. It ranks last in terms of per-capita income and poverty rates. Over the long term, however, it has improved faster than the rest of the US, and its economic indicators are slowly converging with national averages.

Although total nonfarm employment stagnated over the past year, the shifts between industries will benefit the state. Retail trade shed 3,800 jobs in the year that ended in November, while manufacturing gained 3,700. This should bolster personal income as manufacturing tends to have higher-wage jobs. Manufacturing will continue to be boosted by pent-up national demand for cars and trucks, an accelerating national recovery and recent declines

in energy prices, a major input to the manufacturing process and a determinant of demand for driving.

The state unemployment rate ticked down to 7.3% in November from 8.0% a year ago, but remains above the national rate of 5.8%. Mississippi's labor force has been shrinking since 2010. Mississippi's population growth trails the nation's as working-age residents migrate elsewhere in search of better employment prospects. The recent decline in oil prices will slow some of that migration, especially to Texas, as the energy industry cuts back on capital spending and exploration.

Mississippi will gain overall from the decline in oil prices. The state's manufacturing industry will benefit from lower energy costs and Mississippi's car-dependent consumers will have more disposable income. Mitigating these positive effects will be a decline in oil severance taxes, but those only accounted for \$72 million, or 1.3%, of fiscal year 2014 revenues. Also, drilling in the emerging Tuscaloosa Marine Shale region, in the southwest of the state, will be scaled back.

FINANCES AND LIQUIDITY

FINANCES

Mississippi has a stable revenue base that is growing. Over the past 15 years, revenues declined in only two years and the most it declined in any one year was 5%. This is the result of a relatively stable underlying economic base, but is also the product of a wide basket of taxes that dampens volatility. The 7% statewide sales tax is budgeted to net the state \$2.0 billion or 37% of general fund revenues in fiscal 2015 and is on track to bring 2.3% more than estimated as Mississippians benefit from a rising economy and improved consumer confidence due to lower gas prices. Individual income taxes are expected to bring in an additional \$1.7 billion and have also been outperforming the budget as well-paid manufacturing jobs pick up. Corporate income taxes are budgeted to be \$666 million in fiscal 2015 and are also on a pace to exceed budget.

Mississippi's available fund balances, the balance in its general fund that is unassigned, grew to 6.7% of revenues in fiscal 2014 on an unaudited basis, which is stronger than most peer states in the Aa2 rating category. Mississippi built this financial cushion through a combination of conservative revenue forecasting, expenditure restraint and a slowly improving economy. Since the state's rainy day fund is at its statutory cap, available reserves will likely remain at or close to this level even if the economy continues to improve.

LIQUIDITY

Mississippi has healthy liquidity. It has no short-term notes or lines of credit outstanding and has never issued tax anticipation notes, although it is authorized to do so. Mississippi finished fiscal year 2014 with \$644 million in total liquid resources available to the general fund, down from \$679 million at the end of fiscal 2013. The state's general fund uses other funds on an intra-year basis as liquidity support to meet cash flow needs and as of January 16, 2015, owed the rainy day fund \$289 million and other special funds \$167 million, according to the state. The state is required to repay all such borrowing within the fiscal year.

DEBT AND PENSIONS

Debt Structure

Mississippi has above-average fixed costs. Its ratio of net tax-supported debt to the size of its economy was 5.1% using fiscal 2013 data, ranking it 8th-highest. High debt levels relative to most other states are a legacy of deficit-financing infrastructure to support economic development in the 1990s and early 2000s. In recent years, the state has reduced borrowing, improving the health of its balance sheet.

The state decreased its exposure to interest rate risk over the past few years and now its portfolio of bonds outstanding is mostly fixed-rate. It had just \$174 million of variable rate debt as of June 30, 2014, or 3% of total debt.

Debt-Related Derivatives

Mississippi has interest rate swaps outstanding on a notional value of \$174 million of variable rate debt. As of June 30, 2014, the swaps had a fair market value of negative \$22 million, which is manageable in the context of the state's \$8.5 billion in general fund revenues in fiscal 2014 (unaudited).

Pensions and OPEB

Mississippi's pension liabilities are above-average. Its three-year average adjusted net pension liability of \$11.1 billion was 11.6% of personal income as of fiscal 2013. The retirement system reported an improved funded status of 61.0% in fiscal 2014, up from 57.7% in fiscal 2013, the result of reaching the end of the smoothing period for large losses in 2009 and a benign investment environment in fiscal 2014. In 2012, the state set a goal of reaching 80.0% funded status by 2042, replacing the rolling 30-year amortization period. The long-term nature of achieving its funding goals and the lack of major pension reforms on the horizon will result in the state's ranking of 16th-highest liability relative to its size remaining stable in the near future.

Mississippi funds its other post-employment benefits (OPEB) on a pay-as-you-go basis, like most other states. The state's annual required contribution in fiscal 2014 (unaudited), a manageable \$44 million or 0.5% of revenues, has been stable in recent years. The unfunded actuarial accrued liability related to OPEB costs was \$762 million as of June 30, 2014 (unaudited).

GOVERNANCE

Strict budget control mechanisms are mandated by state statute. The administration must reduce allocations to state agencies should revenues fall below 98% of the budgeted estimate in any month after October and may do so before then. This authority was used to maintain a healthy reserve balance during the 2007-2009 recession when peer states in the Aa2 rating category depleted their reserves. The state published its first debt affordability study last year, adding a financial best practice. The study enhances the policy discussion on the state's bonding programs. The state is well below constitutional debt limits.

KEY STATISTICS

Per capita income relative to U.S. average: Aa3 (77.4%)

Industrial diversity (1=most diverse): Aa2 (0.66)

Employment volatility (U.S.=100): Aaa (90)

Financial best practices: Aa1

Financial flexibility/constitutional constraints: Aa2

Revenue diversity, volatility, and growth: Aaa

Available balances as % of operating revenue (5-yr. avg.): Aa1 (6.2%)

Cash management and liquidity: Aa1

NTSD/total governmental revenue: Aa2 (33.3%)

3-year avg. adjusted net pension liability/total governmental revenue: Aa2 (66.8%)

OBLIGOR PROFILE

Mississippi is a state of 3 million people in the Southeast.

LEGAL SECURITY

The Series 2015 bonds are secured by a pledge of the full faith and credit of the state.

USE OF PROCEEDS

The Series 2015 bonds will finance certain capital improvements and economic development projects and will also advance refund and defease certain outstanding general obligation bonds.

RATING METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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